

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.**

In the Matter of)	
)	
Access Charge Reform)	CC Docket No. 96-262
)	
Price Cap Performance Review for Local)	CC Docket No. 94-1
Exchange Carriers)	
)	
Low Volume Long Distance Users)	CC Docket No. 99-249
)	
Federal-State Joint Board on Universal Service)	CC Docket No. 96-45

**Notice of Proposed Rulemaking
On the CALLS Petition**

COMMENTS OF THE COMPETITION POLICY INSTITUTE

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I. INTRODUCTION AND SUMMARY

On August 20, 1999 a coalition of local and long distance companies submitted a multi-faceted proposal to the Federal Communications Commission negotiated among the members of the coalition. The proposal of the Coalition for Affordable Local and Long Distance Services (“CALLS”) is an ambitious attempt to address several nettlesome problems involving the structure of carrier access charges, consumer confusion about line item charges on monthly bills, and the level of funding of the federal universal service fund. The Competition Policy Institute (CPI)¹ appreciates the opportunity to comment on this important proposal.

The CALLS proposal has some advantages for consumers: lower carrier access prices that will lead to reductions in long distance rates, simplified monthly bills, and universal service support. But each of these advantages comes at a substantial cost: higher monthly fixed charges, a shift of costs from interexchange carriers to end-users and total access revenues that will be higher than under the current system. Thus, while there are some meritorious aspects to the CALLS proposal, its shortcomings outweigh its merits, making it unacceptable to the interests of telecommunications consumers.

Because the CALLS proposal is a negotiated product among telecommunications carriers who supply each other and also compete with each other, it is not surprising that its sponsors have offered the proposal as an “all-or-nothing” proposition. We are sure that each feature of the

¹ CPI is an independent, non-profit organization that advocates state and federal policies to promote competition in telecommunications and energy services in ways that benefit consumers. Complete information about CPI can be obtained from our web site at <www.cpi.org>.

proposal represents much give-and-take among the various parties. Of course, this aspect of the proposal is one of its strengths—a consensus among important industry players. But this aspect also betrays one of its weaknesses. The fact is that this proposal was negotiated solely among some industry participants; it does not reflect the input of telecommunications end-users and consumers. As the Commission knows, a “partial settlement” of a complex issue can compromise the interests of parties who were not at the table. This is the case with the CALLS proposal: important consumer interests were either not considered or were negotiated away by the players.

Here are four major shortcomings of the CALLS proposal:

- The proposal is revenue-neutral with respect to the access revenues of local exchange carriers. Instead, because access rates remain inflated, the Commission should order additional prescriptive access cuts on top of scheduled price cap reductions;²
- The proposal is inconsistent with the Commission’s existing policy of reducing carrier access charges by employing a market-based approach, backed up by the potential of additional “prescriptive” access rate reductions.
- The proposal inappropriately eliminates the “X-factor” from the Commission’s price cap formula, eviscerating the theory and practice of price cap regulation.
- The proposal reduces the likelihood that total access revenues (carrier plus end-user) will ever be reduced in the future by regulatory action.

² CPI has advocated this policy in our support of a pending petition. *See* Comments of the Competition Policy Institute in the Matter of the Petition for Rulemaking of the Consumer Federation of America, International Communications Association and National Retail Federation, CC Docket Nos. 96-262, 94-1, 91-213 and 95-72. (*CFA/ICA/NRF Petition*)

II. COMMENTS

A. The proposal does not reduce the level of access charges.

An undeniable merit of the CALLS proposal is that the per-minute charges for exchange access are reduced to levels approximating economic costs. We have no doubt that this will result in lower long distance prices, assuming the IXC's are forced by competitive pressures to pass on these lower costs in the form of lower prices. But the CALLS proposal does not actually lower the access revenues collected by the local exchange companies, it merely shifts recovery of those costs from interexchange carriers onto end users. This cost shift mitigates benefits consumers might otherwise gain from lower long distance rates.

With this fact in mind, it is clear why this proposal is supported by the participating local exchange carriers and interexchange carriers. Under the proposal, the LECs will recover their historic costs in a much more stable way, insulating these revenues from the near-term ravages of competition for exchange access services in favor of the more distant threat of competition for local service. The IXC's get the result they've wanted for a long time: the access prices *they* pay will have been reduced to near economic cost levels. Only end-users in this arrangement lose by inheriting the cost responsibility formerly borne by the IXC's in the first instance. But satisfying the needs of some IXC's and some LECs is not the same as moving access charges to economic costs, a prominent goal of the Commission's agenda.

If the Commission is inclined to modify the proposal, CPI thinks the Commission should make an additional prescriptive reduction in access rates. In our support of the *CFA/ICA/NRF Petition*, we suggested that it is appropriate for the Commission to make such an additional

“down payment” on access charge reform to demonstrate to the LECs that it is serious about driving down the price of access. Either the LECs can permit competition in the local exchange to reduce those prices or the Commission will be the agent of the reductions.

B. The proposal is not consistent with the Commission’s current plan to employ market forces to reduce access charges.

In its last major order on access charges, the Commission committed to a policy course that employs market forces to reduce access charges, backed up by a policy of prescriptive reductions in access levels if market pressures were not sufficient to reduce access prices in an appropriate time frame. CPI supports that approach, believing competition in the exchange access market, boosted by facilities-based and UNE-based local market entry, will keep access charges on a downward trajectory. We also strongly support the Commission’s commitment to use additional prescriptive reductions in access levels if market forces develop too slowly. In its *First Report and Order*, the Commission stated:

In addition, we also adopt a prescriptive “backstop” to our market-based approach that will serve to ensure that all interstate access customers receive the benefits of more efficient prices, even in those places and for those services where competition does not develop quickly.³

The CALLS proposal is a retreat from this policy course. By transforming carrier access charges to end-user surcharges, it short-circuits the ability of the exchange access market to force excess costs out of the LECs’ access rates. Along the way, it reduces the threat that the

³ *First Report and Order*, In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges. CC Dockets Nos. 96-262, 94-1, 91-213 and 95-72, ¶267.

Commission will step in to reduce access rates further if LECs block the development of market forces that would otherwise do so. When considering the CALLS proposal, the Commission must recognize that this is a sharp departure from its current policy, not an adjustment to it.

C. The proposal eviscerates price cap regulation by eliminating the X-factor productivity adjustment.

The CALLS proposal eliminates the “X-factor” of 6.5% in the Commission’s price cap plan after much of the revenue recovery for access has been shifted onto end-users. This is wholly inappropriate and illustrates again how the proposal suffers from having been negotiated without the input of consumers who will actually pay the bills. Eviscerating price caps by eliminating the X-factor is a gratuitous gesture by the participating local exchange carriers on their own behalf and should be rejected by the Commission with dispatch. This feature of the proposal means that consumers will pay billions of dollars in end-user access charges that would otherwise be wrung out of the system by the X-factor. As far as we can tell, there is no justification for this part of the proposal. It was simply needed to get the LECs on board with this proposal, hardly a basis for such a fundamental shift in Commission policy.

CPI recognizes that we no longer operate in a cost-of-service world; this is the reason why price cap regulation is appropriate for services that are exposed to some competition, but not enough to fully discipline those prices. The price cap theory is still correct, as are all of its components, including the offset for productivity gains of the large LECs. It is simply wrong as a matter of economics and policy to pretend, as the CALLS sponsors do, that the LECs’ costs are changing at the rate of inflation and are not affected by productivity gains. When and if exchange

access service is subjected to the discipline imposed by competition, price cap regulation, indeed any kind of economic regulation, will not be needed or appropriate. That time has not arrived and it is impossible to conclude that it will arrive on the CALLS sponsors' schedule.

When discussing the ILECs' price cap regulation, it is important to consider what the future holds for the ILECs with respect to their access facilities, the cost of which is being recovered by these restructured end-user access charges. First, the cost of the non-traffic sensitive plant continues to fall as fiber technology displaces copper in outside plant and interoffice facilities. Second, fill rates of existing copper loop facilities are increasing as consumers order second and third lines, spreading the NTS revenue requirement over more revenue-producing facilities.

Third, and most important, LECs are finding new uses for old copper plant—DSL services, for example. The skyrocketing growth of DSL and the ambitious DSL plans announced by the ILECs show dramatically that the copper wire once thought to be stranded-costs-in-the-making is actually the key to these companies' revenue growth in the intermediate term. The old cost-recovery model, on which today's access charge structure is ultimately based, assumed that copper loops were for voice service and its add-ons. This assumption is wrong now, reducing the ILECs' claim for the right to a guaranteed recovery of these costs.

Bottom line, the future for the LECs is bright and we fully expect their return on investment for access facilities to continue to exceed market returns, *even with the 6.5% productivity factor in place*. In fact, there is a strong argument that the 6.5% factor is too low. There is evidence before the Commission in its access reform dockets that convincingly argues the

factor should be increased to 9.5%. In any event, there is no justification for eliminating the X-factor.

D. The proposal shifts the burden onto end users, reducing the likelihood that total access revenues will ever be reduced.

We suspect that the Commission will receive many comments about who has responsibility for paying to use the LECs' network to provide long distance service: carriers or end users. We focus here on a different aspect of the same issue: how the regulatory process is affected by shifting access charges from carriers onto end-users.

Historically, pressure for reduced access charges has come mainly from the purchasers of access, the IXC's. This has come in two forms: in the marketplace, IXC's have put pressure on the LECs by seeking out access arrangements that bypassed the LECs. Second, IXC's have been vigilant in regulatory proceedings, providing the Commission with essential information and advocacy that put pressure on access charges through the regulatory process.

One of the effects of the CALLS proposal is to take IXC's out of the regulatory picture. This reduces substantially the likelihood that the new end user charges negotiated by the CALLS sponsors will ever be reduced through regulatory action, regardless of the changing future for the LECs.

IV. CONCLUSION

The CALLS Petition must be greatly modified before it serves consumers' interests. While some of its features would benefit consumers in specific ways, these benefits are offset by the shift of access cost responsibility away from carriers and onto end-user consumers. This shift occurs at a time when the Commission should be reducing access charges more rapidly than the Commission's price cap plan is doing. Moreover, the modification of the price cap plan in the CALLS proposal ensures that total access charges (carrier plus end-user) will be higher than they would be absent this proposal. This is not progress.

Since the CALLS petitioners have presented this as an all-or-nothing proposal, it is difficult to see how the Commission can rescue the proposal without invoking the opposition of some of the key CALLS members. In view of this, we think the Commission has no choice but to reject the proposal.

Respectfully submitted,

/s/ _____

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